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Federal Communications Commission
Office of the Secretary

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D. C. 20554

In the Matter of	)	
	)	CC Docket No. 92-91
Open Network Architecture	)	
Tariffs of Bell Operating	)	
Companies	)	

DIRECT CASE OF THE NYNEX TELEPHONE COMPANIES

New England Telephone and
Telegraph Company and
New York Telephone Company

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Dated: May 18, 1992

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DIRECT CASE OF THE NYNEX TELEPHONE COMPANIES

The NYNEX Telephone Companies, New England Telephone and Telegraph Company and New York Telephone Company ("NET" and "NYT", respectively; the "NTCs", collectively), submit this Direct Case pursuant to the Order Designating Issues for Investigation released on April 16, 1992 in the above-entitled proceeding (the "Designation Order"). This Direct Case demonstrates the lawfulness of rates for Basic Service Elements ("BSEs") contained in the NTCs' Open Network Architecture Tariff Filing dated November 1, 1991 (the "ONA Tariff Filing").

I. INTRODUCTION

In its Part 69 ONA Order[1] released on July 11, 1991,

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1 Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture and Policy and Rules Concerning Rates for Dominant Carriers, Report and Order & Order on Further

(Footnote Continued On Next Page)

the Federal Communications Commission (the "Commission") ordered Local Exchange Carriers ("LECs") to file tariffs and support material to unbundle Open Network Architecture ("ONA") services.[2] The NTCs' ONA Tariff Filing was made in compliance with the Part 69 ONA Order.

Subsequently, on January 31, 1992, the Commission's Common Carrier Bureau (the "Bureau") initiated an investigation into the lawfulness of ONA rates.[3] The NTCs' ONA Tariff Filing was suspended for one day and an accounting order was imposed. The issues to be investigated were specified by the Bureau in the Designation Order.

The Designation Order requires the NTCs to respond to the following questions:

> Have carriers selected model offices that are representative of offices that will be used to provide BSEs? (Designation Order, Question 2)
>
> Is use of a cost of money that exceeds 11.25 percent reasonable? (Designation Order, Question 3)
>
> Should 1ESS and/or 1AESS switch costs be included in the development of BSE rates? (Designation Order, Question 4)
>
> Are differences between BSE rates and unit costs differences justified? (Designation Order, Question 7)

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1 (Footnote Continued From Previous Page)

Reconsideration & Supplemental Notice of Proposed Rulemaking, CC Docket Nos. 89-79 and 87-313, released July 11, 1991 ("Part 69 ONA Order").

2 See Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase I, 4 FCC Rcd 1 (1988), recon., 5 FCC Rcd 3084, further order, 5 FCC Rcd 3103 (1990).

3 Bell Atlantic Telephone Companies, et al., Open Network Architecture Tariffs, Memorandum Opinion and Order, DA 92-128, released January 31, 1992 ("ONA Investigation Order").

The NTCs' responses are summarized below, and set forth in detail in Appendix A hereto.

II. SUMMARY OF DIRECT CASE

A. Prescribing Costing Or Pricing Methodologies In This Context Would Be Inconsistent With The Commission's Program of Incentive Regulation.

The purpose of this Direct Case is to provide further explanation and support for the NTCs' ONA Tariff Filing. The Direct Case does not propose or support the adoption by the Commission of costing or pricing requirements to be applied here or in other contexts.

The NTCs have previously shown how the application of rigid costing and pricing requirements, developed in the context of rate of return regulation, will defeat the Commission objectives of creating incentives to innovation.[4] The Commission itself has recognized that there are "economic benefits to be obtained from moving away from a system in which regulators dictate prices on the basis of fully distributed costing principles, toward a system of limited pricing flexibility."[5]

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4 See Petition for Clarification and Reconsideration, dated August 26, 1991, filed by the NTCs in proceedings entitled Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture and Policy and Rules Concerning Rates for Dominant Carriers, CC Docket Nos. 89-79 and 87-313. Relevant excerpts from the NTCs' petition are attached hereto as Appendix B.

5 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, released October 4, 1990, 5 FCC Rcd 6786, 6791, ¶ 35 (1990).

The Commission has cited "a flexible cost-based approach to pricing new services" as the best way to encourage innovation while preventing unreasonably discriminatory pricing.[6] Among other things, to provide flexibility needed to achieve efficient pricing, the Commission has permitted LECs to develop their own costing methodologies and declined to mandate uniform loadings.[7]

The ONA Tariff Filings are the outgrowth of ONA, which was "designed to unbundle certain services provided by BOCs in order to promote efficient and innovative use of the network by independent enhanced service providers . . . and to prevent discrimination."[8] Even if the Commission were inclined to abandon the precepts of incentive regulation and to develop costing and pricing principles of general application, this unique proceeding is not the appropriate one in which to do so.

B. The NTCs' ONA Tariff Filing Rates Are Lawful.

This Direct Case demonstrates the lawfulness of the NTCs' ONA Tariff Filing rates. First, the NTCs show that they selected model offices that are representative of offices used to provide BSEs. To develop investments using the Switching Cost Information System ("SCIS"), the NTCs excluded data relating to offices or technologies that would not be used to provision BSEs, and used data for approximately 73% of the remaining switching

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6 Part 69 ONA Order, ¶ 38.

7 Part 69 ONA Order, ¶¶ 42, 44.

8 ONA Investigation Order, ¶ 1.

offices and remotes in service in the NYNEX territory during the period when SCIS data were collected.

Second, the NTCs show that their use of costs of money exceeding 11.25% was reasonable. NYT used costs of money exceeding 11.25% as inputs to SCIS to determine switch processor utilization. Because SCIS levelizes switch processor utilization over the life of the switch, the use of a forward-looking cost of money that may exceed 11.25% is justified. Moreover, use of these various costs of money for this purpose does not significantly affect the results yielded by SCIS.

Third, the NTCs explain why they included 1ESS and 1AESS switch costs in developing BSE rates. Among other things, the NTCs considered the facts that BSEs are provided using analog technology and that no significant shifts in technology mix are forecast through 1994. The NTCs concluded that use of analog costs was therefore appropriate for the NTCs in the context of the ONA Tariff Filing.

Finally, the NTCs show that differences between rates and unit costs for two of their BSEs -- Three Way Calling and Multiline Hunt Group -- are justified. Rates for the Three Way Calling BSE have been set at levels equal to state rates for the Three Way Calling service that is offered on an intrastate basis. Parity of state and federal rates is necessary to prevent arbitrage between the two jurisdictions that could defeat state regulatory objectives and have a negative effect on total company revenue. The difference in rates and unit costs for the Multiline Hunt Group BSE is attributable solely to rounding conventions used in making the necessary calculations.

III. CONCLUSION

For the reasons summarized above and set forth in detail in the Direct Case contained in Appendix A which follows, the Commission should conclude that the NTCs' ONA Tariff Filing rates are reasonable and lawful.

Respectfully submitted,

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New York Telephone Company

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Dated: May 18, 1992

APPENDIX A

Direct Case

HAVE CARRIERS SELECTED MODEL OFFICES THAT ARE REPRESENTATIVE OF OFFICES THAT WILL BE USED TO PROVIDE BSEs? (DESIGNATION ORDER, QUESTION 2)

The model office data base developed by the NTCs for use in SCIS is representative of the switching offices and remotes that will be used to provide BSEs.

In developing the model office data base, the NTCs considered the technology mix that would be used to provide BSEs. Data for offices or technologies that would not be used to provision BSEs were excluded. Of the remaining offices in service during the period when SCIS data were collected, data for approximately 73% of those offices were included in the model office data base. This 73% is representative of all states and all switch sizes for each switch technology utilized to provision BSEs. Data for the other 27% of those offices were not included in the data base due to such random factors as incomplete or unavailable traffic data or an ongoing conversion process in the particular office.

The following assumptions underlie the inputs into SCIS of switch replacement schedule and switch utilization at replacement: A number of factors influence the timing of switch replacements. Although exhaust of switch capacity is typically a primary consideration, there are a number of engineering inputs that determine replacement date. These include the central processor occupancy; the trend rate of CCS per main station; the forecasted growth rates; the ability to

offer new services; the load the new services put on the switch; the memory of the switch, such as program and data store; the line and trunk capacity; the administrative capacity of the switch; input/output port restrictions; the ability to make recent change messages; and the ability to provide billing data.

In some instances, exhaust of switch capacity is a factor of lesser importance in determining replacement. For example, consideration of next generation switching technology and network upgrades may result in switch replacement based primarily on technological obsolescence. For any given end office, the engineer must consider equipment limitations in light of traffic information and forecasted growth to anticipate obsolescence and determine an expected retirement date. In fact, consideration of factors such as the foregoing may result in replacement of a switch before it reaches processor capacity.

It should also be noted that digital switch technology utilizes modular components. Technological advancements may be accommodated by replacement of individual switch components, rather than the switch itself. In fact, many of the NTCs' digital switches have already had, or are scheduled for, processor replacements. Thus, when an engineer is estimating replacement dates, consideration is given to such technological alternatives to total switch replacement.

IS USE OF A COST OF MONEY THAT EXCEEDS 11.25 PERCENT REASONABLE? (DESIGNATION ORDER, QUESTION 3)

NYT used costs of money above 11.25% as inputs into SCIS to determine switch processor utilization for use in computing average material investment.[1] Because SCIS levelizes switch processor utilization over the life of the switch, the use of a forward-looking cost of money that may exceed 11.25% is justified. Moreover, use of costs of money higher than 11.25 for this purpose within the SCIS model does not significantly affect the unit investments yielded by SCIS since the cost of money factor is applied to both the numerator and denominator of the equation used to calculate switch processor utilization.

It should be noted that the use of a cost of money factor in the calculation of BSE investment is distinctly different from the use of cost of money in calculating the return to be earned on the BSE investments. In calculating the return to be earned on the BSE investments -- a calculation made by the NTCs, external to SCIS -- the NTCs applied a cost of money of 11.25%.

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1 These cost of money SCIS inputs have not been disclosed on the public record. They have been provided to the Commission, in camera, and to Arthur Andersen & Co. and intervenors in the ONA access tariff proceedings subject to confidentiality agreements pursuant to the Commission's Memorandum Opinion and Order, released on January 31, 1992, in a proceeding entitled Commission Requirements for Cost Support Material to be Filed with Open Network Architecture Access Tariffs, DA 92-129.

SHOULD 1ESS AND/OR 1AESS SWITCH COSTS BE INCLUDED IN THE DEVELOPMENT OF BSE RATES? (DESIGNATION ORDER, QUESTION 4)

The NTCs used both 1ESS and 1AESS costs in the development of their ONA Tariff Filing rates based on their determination that BSEs would, in fact, be provisioned using analog technology. A July 1992 time point was used to determine the technology mix. The July 1992 ratios were determined to be the representative mix since no significant shifts in technology mix of access lines were forecast through 1994.

The use of analog technology does not result in excessively high rates. First, use of this technology mix directly reflects the underlying cost structure. Second, if the NTCs had developed rates excluding the analog technology, as shown in Attachment A Exhibit 1 which follows, rates for three BSEs in NET and two BSEs in NYT would actually increase.[2] This is due to the fact that use of the 1AESS technology is less costly for these particular BSEs.

The fact that exclusion of analog technology would result in higher rates for certain BSEs illustrates how the use of embedded technology in this context results in lower costs,

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2 The difference between the number of NET BSEs and NYT BSEs for which rates would increase is due to the NYT investments associated with the 1ESS technology. The Hunting BSE is more costly on the 1ESS. By excluding this technology, NYT would have a rate decrease. NET is not affected in this way because it does not use 1ESS technology to provision the Hunting BSE, whereas NYT uses both IESS and IAESS technology.

and reduced rates that encourage provisioning of services. More important, however, it illustrates the need for freedom from hard-and-fast costing and pricing requirements in this and other contexts. Efficient pricing -- which benefits the LECs and their ratepayers, encourages innovation, and fosters effective competition -- is predicated on the ability to respond flexibly to the context in which a service is offered. Efficient pricing is predicated on flexibility to consider in context such factors as technology mix, market conditions, and forecast demand, and the appropriate weight to be given to each such relevant factor.

The NTCs respectfully submit that there is only one constraint on costing and pricing that should be applied in all contexts. That constraint is a requirement to demonstrate that rates are equal to or greater than long run incremental costs. As the NTCs have shown, in the increasingly competitive markets in which they do business, additional constraints are unnecessary and actually hinder the achievement of Commission goals.[3]

The following Attachment A Exhibit 1 is a listing of the BSE rates that would have resulted if the 1ESS and 1AESS switch technologies had been excluded from the NTCs' costing and rate making process. Attachment A Exhibit 2 provides cost support for the rates displayed in Exhibit 1.

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3 See Appendix B hereto.

BSE COSTS AND THEORETICAL RATES WITH 1A AND 1E TECHNOLOGIES OMITTED
NEW ENGLAND TELEPHONE, NEW YORK TELEPHONE, AND UNIFIED

BSE	NET COST	THEORETICAL NET RATE	NET FILED RATE	NYT COST	THEORETICAL NYT RATE	NYT FILED RATE **	UNIFIED COST	THEORETICAL UNIFIED RATE	UNIFIED RATE FILED FOR EFFECT JULY 1, 1992 **
ANI PER ATTEMPT	0.000594	0.000600	0.001343	0.000721	0.000800	0.001746	0.000672	0.000700	0.001589
ALTERNATE ROUTING PER TRUNK GROUP									
ANNUAL	4.795164			5.332287			4.940636		
MONTHLY	0.399597	0.40	0.26	0.444357	0.44	0.31	0.411720	0.41	0.27
HUNTING PER LINE									
ANNUAL	1.277302			2.282805			2.002254		
MONTHLY	0.106442	0.11	0.10	0.190234	0.19	0.27	0.166855	0.17	0.22
UCD PER LINE									
ANNUAL	2.513802			5.959769			5.613156		
MONTHLY	0.209484	0.21	0.19	0.496647	0.50	0.42	0.467763	0.47	0.40
3 WAY CALLING PER LINE									
ANNUAL	5.511137			5.408837					
MONTHLY	0.459261	*	*	0.450736	*	*	*	*	*
QUEING PER LINE									
ANNUAL	3.113388			3.741612			3.652492		
MONTHLY	0.259449	0.26	0.82	0.311801	0.31	1.00	0.304374	0.30	0.97
ANNOUNCEMENT PER LINE									
ANNUAL	29.615233			33.191484			32.69247		
MONTHLY	2.467936	2.47	3.38	2.765957	2.77	3.83	2.724373	2.72	3.77

* NYNEX WOULD CONTINUE TO PRICE THIS BSE EQUAL TO THE 3 WAY CALLING STATE RATES

** THE CURRENT EFFECTIVE RATES FOR NYT ARE NOT SET EXACTLY AT COSTS DUE TO A COST CALCULATION ERROR DISCOVERED AFTER THE ONA TARIFF FILING, FILED ON NOVEMBER 1, 1991. THIS ERROR WAS EXPLAINED AND QUANTIFIED IN TRANSMITTAL NO. 78, FILED ON FEBRUARY 10, 1992. AS EXPLAINED IN THAT FILING THE ERROR HAD A DEMINIMUS EFFECT ON THE COSTS THEREFORE THE RATES WERE NOT ADJUSTED. THE THEORETICAL UNIFIED RATES SHOWN HERE DO REFLECT CORRECTION OF THE ERROR. THE PROPOSED UNIFIED RATES FILED MAY 15, 1992 FOR EFFECT JULY 1, 1992 REFLECT A UNIFICATION OF THE CURRENT EFFECTIVE RATES FOR NET AND NYT AND THEREFORE ARE NOT CORRECTED FOR THAT ERROR.

Appendix A
Attachment A
Exhibit 1
Page 1 of 1

BSE COST DEVELOPMENT BSE COSTS WITH 1A AND 1E OMITTED FOR DESIGNATION ORDER STUDY

NYNEX

	UNIT INVESTMENT	MAINTENANCE	DEPRECIATION	COST MONEY	TAXES	OTHER	ADMIN.	TOTAL DIRECT	OVERHEAD	TOTAL DIRECT AND OVERHEAD
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H) (B+C+D+E+F+G)	(I)	(J) (H+I)
ANI	0.001532									
PER ATTEMPT		$0.000080	$0.000150	$0.000085	$0.000023	$0.000053	$0.000009	$0.000400	$0.000272	$0.000672
ALTERNATE ROUTING	12.297241									
PER TRUNK GROUP										
ANNUAL COST		$0.650717	$1.229464	$0.668749	$0.182115	$0.254835	$0.074221	$3.060101	$1.880535	$4.940636
MONTHLY COST (ANNUAL/12)										$0.411720
HUNTING	4.371077									
PER LINE										
ANNUAL COST		$0.225036	$0.422200	$0.247093	$0.066309	$0.181811	$0.025741	$1.168190	$0.834064	$2.002254
MONTHLY COST (ANNUAL/12)										$0.166855
UCD	11.822981									
PER LINE										
ANNUAL COST		$0.603659	$1.130093	$0.675868	$0.180619	$0.564949	$0.069110	$3.224298	$2.388858	$5.613156
MONTHLY COST (ANNUAL/12)										$0.467763
3 WAY CALLING NET	23.296021									
PER LINE										
ANNUAL COST		$0.784598	$1.486949	$0.782312	$0.214528	$0.164976	$0.089380	$3.522743	$1.988394	$5.511137
MONTHLY COST (ANNUAL/12)										$0.459261
3 WAY CALLING NYT	20.305598									
PER LINE										
ANNUAL COST		$0.572801	$1.071485	$0.645769	$0.172323	$0.562427	$0.065599	$3.090404	$2.318433	$5.408837
MONTHLY COST (ANNUAL/12)										$0.450736
QUEING	7.853290									
PER LINE										
ANNUAL COST		$0.402907	$0.755227	$0.446041	$0.119488	$0.347092	$0.046104	$2.116859	$1.535633	$3.652492
MONTHLY COST (ANNUAL/12)										$0.304374
ANNOUNCEMENT	70.396141									
PER LINE										
ANNUAL COST		$3.612849	$6.772675	$3.996430	$1.070769	$3.093466	$0.413397	$18.959586	$13.732887	$32.692473
MONTHLY COST (ANNUAL/12)										$2.724373

BSE COST DEVELOPMENT

BSE COSTS WITH 1A AND 1E OMITTED FOR DESIGNATION ORDER STUDY

NEW ENGLAND TELEPHONE

	UNIT INVESTMENT	MAINTENANCE 0.053565	DEPRECIATION 0.101515	COST MONEY 0.053409	TAXES 0.014646	OTHER 0.011263	ADMIN. 0.006102	TOTAL DIRECT	OVERHEAD 0.135749	TOTAL DIRECT AND OVERHEAD
	(A)	(B) (A*.053565)	(C) (A*.101515)	(D) (A*.053409)	(E) (A*.014646)	(F) (A*.011263)	(G) (A*.006102)	(H) (B+C+D+E+F+G)	(I) (A*.135749)	(J) (H+I)
ANI	0.001579									
PER ATTEMPT		$0.000085	$0.000160	$0.000084	$0.000023	$0.000018	$0.000010	$0.000380	$0.000214	$0.000594
ALTERNATE ROUTING	12.744657									
PER TRUNK GROUP										
ANNUAL COST		$0.682668	$1.293774	$0.680679	$0.186658	$0.143543	$0.077768	$3.065090	$1.730074	$4.795164
MONTHLY COST (ANNUAL/12)										$0.399597
HUNTING	3.394831									
PER LINE										
ANNUAL COST		$0.181844	$0.344626	$0.181315	$0.049721	$0.038236	$0.020715	$0.816457	$0.460845	$1.277302
MONTHLY COST (ANNUAL/12)										$0.106442
UCD	6.681219									
PER LINE										
ANNUAL COST		$0.357879	$0.678244	$0.356837	$0.097853	$0.075251	$0.040769	$1.606833	$0.906969	$2.513802
MONTHLY COST (ANNUAL/12)										$0.209484
3 WAY CALLING	14.647578									
PER LINE										
ANNUAL COST		$0.784598	$1.486949	$0.782312	$0.214528	$0.164976	$0.089380	$3.522743	$1.988394	$5.511137
MONTHLY COST (ANNUAL/12)										$0.459261
QUEING	8.274805									
PER LINE										
ANNUAL COST		$0.443240	$0.840017	$0.441949	$0.121193	$0.093199	$0.050493	$1.990091	$1.123297	$3.113388
MONTHLY COST (ANNUAL/12)										$0.259449
ANNOUNCEMENT	78.711795									
PER LINE										
ANNUAL COST		$4.216197	$7.990428	$4.203918	$1.152813	$0.886531	$0.480299	$18.930186	$10.685047	$29.615233
MONTHLY COST (ANNUAL/12)										$2.467936

BSE COST DEVELOPMENT

BSE COSTS WITH 1A AND 1E OMITTED FOR DESIGNATION ORDER STUDY

NEW YORK TELEPHONE

	UNIT INVESTMENT	MAINTENANCE 0.050907	DEPRECIATION 0.095227	COST MONEY 0.057392	TAXES 0.015315	OTHER 0.049985	ADMIN. 0.005830	TOTAL DIRECT	OVERHEAD 0.206048	TOTAL DIRECT AND OVERHEAD
	(A)	(B) (A*.050907)	(C) (A*.095227)	(D) (A*.057392)	(E) (A*.015315)	(F) (A*.049985)	(G) (A*.005830)	(H) (B+C+D+E+F+G)	(I) (A*.206048)	(J) (H+I)
ANI	0.001502									
PER ATTEMPT		$0.000076	$0.000143	$0.000086	$0.000023	$0.000075	$0.000009	$0.000412	$0.000309	$0.000721
ALTERNATE ROUTING	11.092661									
PER TRUNK GROUP										
ANNUAL COST		$0.564694	$1.056321	$0.636630	$0.169884	$0.554467	$0.064670	$3.046666	$2.285621	$5.332287
MONTHLY COST (ANNUAL/12)										$0.444357
HUNTING	4.748878									
PER LINE										
ANNUAL COST		$0.241751	$0.452221	$0.272548	$0.072729	$0.237373	$0.027686	$1.304308	$0.978497	$2.282805
MONTHLY COST (ANNUAL/12)										$0.190234
UCD	12.398005									
PER LINE										
ANNUAL COST		$0.631145	$1.180625	$0.711546	$0.189875	$0.619714	$0.072280	$3.405185	$2.554584	$5.959769
MONTHLY COST (ANNUAL/12)										$0.496647
3 WAY CALLING	11.251907									
PER LINE										
ANNUAL COST		$0.572801	$1.071485	$0.645769	$0.172323	$0.562427	$0.065599	$3.090404	$2.318433	$5.408837
MONTHLY COST (ANNUAL/12)										$0.450736
QUEING	7.783609									
PER LINE										
ANNUAL COST		$0.396240	$0.741210	$0.446717	$0.119206	$0.389064	$0.045378	$2.137815	$1.603797	$3.741612
MONTHLY COST (ANNUAL/12)										$0.311801
ANNOUNCEMENT	69.047656									
PER LINE										
ANNUAL COST		$3.515009	$6.575201	$3.962783	$1.057465	$3.451347	$0.402548	$18.964353	$14.227131	$33.191484
MONTHLY COST (ANNUAL/12)										$2.765957

ARE DIFFERENCES BETWEEN BSE RATES AND UNIT COSTS DIFFERENCES JUSTIFIED? (DESIGNATION ORDER, QUESTION 7)

The Commission has directed the NTCs to justify the rate to unit cost ratios for the NTCs' Three Way Calling BSE and NET's Multiline Hunt Group BSE.

The ratio for Three Way Calling is attributable to the fact that rates for that BSE have been set at levels of existing intrastate Three Way Calling Business rates, which significantly exceed total unit costs. Rates have been set at state levels for two reasons: to avoid adverse effects of arbitrage and to satisfy requirements of the Net Revenue Test.

State rates for Three Way Calling exceed total unit cost because state regulators have built in amounts to be used as contribution subsidizing residential rates and protecting universal service. To offer the same service in the interstate jurisdiction, at a reduced rate, would result in migration from the state offering. Such arbitrage would adversely impact state regulatory policies and the ability of state regulators to maintain reasonable rates.

The seriousness of this concern is evident in several ONA pleadings submitted by the Public Service Commission of the District of Columbia ("DCPSC"). That regulatory body concluded that Enhanced Service Providers have "a self-interest in reporting a larger volume of traffic for whichever jurisdiction has lower rates, and, to the extent that services cannot be measured, the tariffing of identical features in both the interstate and intrastate jurisdictions will result in tariff

shopping."[4] The DCPSC has objected to rates for interstate BSEs that are less than state rates for the same service on the grounds that elasticity of demand between the jurisdictions will force reductions in state rates that now provide contribution to basic residential rates.

Where state rates exceed interstate rates, elasticity of demand between the jurisdictions may also result in failure to satisfy the Net Revenue Test. The Net Revenue Test ensures that a company's net revenues are greater if a particular service is offered than if it is not. Included as part of the Net Revenue Test is a consideration of the cross-elastic effects of the service offered and, therefore, the total revenue effect on the company is addressed. If interstate rates are set at levels below state rates for the same service, migration from the state to the interstate offering will result in a loss of the revenue from the state offering that exceeds interstate revenues for the service. Thus, if the NTCs' interstate rates for Three Way Calling had been set at total unit costs rather than at state rate levels, the NTCs would fail to satisfy provisions of the Net Revenue Test due to the cross-elasticity between jurisdictions.

The rate to unit cost ratio for NET's Multiline Hunt Group BSE is explained by the use of appropriate rounding

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4 See Petition to Reject, dated November 26, 1991, filed by the Public Service Commission of the District of Columbia in proceedings entitled In the Matter of Bell Atlantic Telephone Companies/ONA Access Charge Tariff Filings, Transmittal No. 471, p. 4.

conventions in making the underlying calculations. The NET ratio of rate to unit cost for the Multiline Hunt Group BSE is identified as 1.0440 on Attachment B to the Designation Order. The associated cost component to this ratio is 1.149459;[5] the associated rate component is 1.20. This rate was derived by dividing the annual cost of 1.149459 by 12 to arrive at the monthly cost of .095788. This monthly cost was then converted to a two-digit monthly rate by rounding to the nearest penny to equal .10. The annual rate component of the ratio was arrived at by multiplying the monthly rate of .10 by 12 to equal 1.20. Thus, due to appropriate rounding during the conversion of the cost plus overhead to a two digit rate for this BSE, the resulting ratio of rate to unit cost is 1.0440. Rounding of certain BSE rate elements was required because the NET billing system for flat monthly rated BSEs cannot accommodate rates with more than two entries to the right of the decimal point.

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5 See NTCs' ONA Tariff Filing, Appendix C, Workpaper CostDev, page 2 of 3.

APPENDIX B

Excerpts from Petition for Clarification and Reconsideration, dated August 26, 1991, filed by the NTCs in proceedings entitled Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture and Policy and Rules Concerning Rates for Dominant Carriers, CC Docket Nos. 89-79 and 87-313

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendments of Part 69	)	
of the Commission's Rules	)	CC Docket No. 89-79
Relating to the Creation of	)	
Access Charge Subelements for	)	
Open Network Architecture	)	
	)	
Policy and Rules Concerning Rates	)	CC Docket No. 87-313
for Dominant Carriers	)	

PETITION FOR CLARIFICATION AND RECONSIDERATION

New York Telephone Company
and New England Telephone
and Telegraph Company

By: Mary McDermott
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Their Attorneys

Dated: August 26, 1991

basis, by CIC, would reduce the opportunity for arbitrage because a customer would be effectively required to take either bundled or unbundled services for all trunks in the LATA, by CIC, rather than ordering originating trunks at the bundled rate and terminating trunks at the unbundled rate to obtain the cheapest total rate.

III. REVISION OF THE CRITERIA FOR THE PRICING OF NEW SERVICES WOULD PROVIDE GREATER CONSISTENCY WITH COMMISSION OBJECTIVES BY PROVIDING GREATER PRICING FLEXIBILITY.

The Commission's decision to move from rate of return to price cap regulation represents the Commission's approval and adoption of incentive regulation as a means to stimulate innovation and improvements. Pricing flexibility is a cornerstone of incentive regulation and, as shown below, undue restriction of the pricing of new services is inconsistent with the Commission's regulatory policies and objectives.

Commission objectives can best be achieved through pricing of new services that allows for (i) earnings on the expenses associated with the development and introduction of new products and (ii) earnings on the combined total of capital and expenses at a level that is not limited to the authorized rate of return. Adequate safeguards exist to ensure that, if the Local Exchange Carriers ("LECs") are given this flexibility, the pricing of new services will be fair, just and reasonable.

A. The Commission Has Recognized That Pricing Flexibility Is Necessary To Achieve The Objectives Of Incentive Regulation.

The Commission has recognized that there are "economic benefits to be obtained from moving away from a system in which regulators dictate prices on the basis of fully distributed costing principles, toward a system of limited pricing flexibility."[30] One of the benefits to be obtained through pricing flexibility is the creation of incentives to innovation:

> [W]e reaffirm the basic policy judgment that a properly designed system of incentive regulation will be an improved form of regulation, generating greater consumer benefits. . . . As a result of the incentives created by this form of regulation, carriers have strong incentives to innovate. Incentive regulation also provides an opportunity to de-emphasize cost allocation systems that depend on fully distributed costing methods to derive LEC rates, a pricing methodology that we believe may generate consumer welfare losses.[31]

Pricing flexibility is critical to the development of new products and services:

> Superior products and production processes are not the result of happenstance. . . . They result instead from the expenditure of effort and resources by individuals or

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30 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, released October 4, 1990, 5 FCC Rcd. 6786, 6791, ¶ 35 (1990) ("Second Report and Order").

31 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Supplemental Notice of Proposed Rulemaking, released March 12, 1990, ¶¶ 2-3.